BEFORE THE CALIFORNIA ENERGY RESOURCES CONSERVATION AND DEVELOPMENT COMMISSION

In the Matter of: Preparation of the *2005 Integrated Energy Policy Report*	Docket No. 04-IEP-1K

COMMENTS OF DUKE ENERGY NORTH AMERICA ON THE 2005 COMMITTEE DRAFT TRANSMITTAL OF 2005 ENERGY REPORT RANGE OF NEED AND POLICY RECOMMENDATIONS TO THE CALIFORNIA PUBLIC UTILITIES COMMISSION

Melanie Gillette

Director, State Regulatory Affairs
Duke Energy North America
980 Ninth Street, Suite 1420
Sacramento, CA 95814
Phone: (916) 441-6233
Fax: (916) 441-2569)
mlgillette@duke-energy.com

Andrew B. Brown

Ellison Schneider & Harris L.L.P.
2015 H Street
Sacramento, CA 95814
Tel: (916) 447-2166
Fax: (916) 447-3512
Email: glw@eslawfirm.com

Attorneys for Duke Energy North America

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Pursuant to the Notice of Committee Hearing and Availability of the 2005 Committee Draft Transmittal Report, Duke Energy North America ("DENA") provides these comments for the Committee's consideration. For the reasons explained below, DENA urges the CEC to recommend to the California Public Utilities Commission ("CPUC") that 3-5 year "interim contracts" be pursued to shore up the availability of existing resources while additional work is completed with respect to development of full resource adequacy implementation and a formalized capacity market.

The Transmittal Report includes policy recommendations that are aimed at phasing out older power plants. The Transmittal identifies approximately 50 power plants throughout the state that have been relied on in recent years to meet peak demand.[1] The CEC advocates the replacement of these plants on a pre-ordained basis, presumably via long-term contracts with the utilities. To forward this policy recommendation, the CEC advocates imputing an additional capacity requirement to the IOUs, irrespective of whether those assets are in fact included in the utility's portfolio developed to meet customer needs and satisfy regulatory requirements such as

[1] This number excludes publicly owned utility generation assets that are similarly situated in terms of vintage to investor owned utility generation assets.

the Resource Adequacy Requirement ("RAR").[2] The rate of capacity phase-out is 25% of the utility's aged unit capacity per year beginning in 2009 such that the all the identified resources are retired by 2012.

DENA believes that the CEC's ultimate goals are laudable (namely more efficient and environmentally acceptable resources), but that the means of pursuing the goals through a strict phase-out approach may not be necessary as improved market structures are anticipated to be operating in that timeframe. However, as DENA has stressed for some time, a 3-5 year interim contracting approach for existing resources should be undertaken to maintain the availability of existing resources for reliability purposes pending full implementation of RAR and a formal capacity market.[3]

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[2] See Transmittal Report, page 46:

> To facilitate the retirement of these aging power plants, the Energy Commission ***has apportioned these 50 plants to the three IOUs based on their physical location, along with their existing capacity and the average energy produced in 2002 through 2004***. In order to ensure that sufficient investment takes place in the next round of procurement to provide for the orderly replacement of the retiring plants with new resources, ***the Energy Commission is including the full amount of the existing capacity and average energy generation of these plants for 2002 through 2004 in the identified need for each of the IOUs for 2012 and beyond***.

[3] See, e.g., DENA's involvement before the CPUC in its *Comments of Duke Energy North America on the Proposed Decision of ALJ Wetzell Regarding Resource Adequacy Issues*, September 20, 2004 in R.04-04-003 arguing that the utilities should be given interim or transitional procurement authority to secure capacity in anticipation of RAR; *Opening Brief of Duke Energy North America on Electric Utility Resource Planning*, October 18, 2004 in R.04-04-003 arguing in favor of a interim contracting arrangement as described in testimony presented in that case; *Reply Brief of Duke Energy North America on Electric Utility Resource Planning,* November 1, 2004 in R.04-04-003, arguing for interim steps to maintain availability of existing capacity while focusing on the eventual development of a formal capacity market structure; *Comments of Duke Energy North America on the Proposed Decision of ALJ Brown Regarding Electric Utility Long Term Resource Plans*, December 6, 2004 in R.04-04-003 arguing for including authority for interim procurement contracts with existing capacity; C*omments of Duke Energy North America In Response to Commissioner's Ruling Regarding Interim Resource Adequacy Obligation*, February 18, 2005 in R.04-04-003; *Supplemental Comments of Duke Energy North America Concerning Latest Round of Workshops on Resource Adequacy Issues*, May 10, 2005 in R.04-04-003; *Comments of Duke Energy North America Regarding Draft Energy Action Plan II*, July 1, 2005 letter to CEC President Peevey and CEC Chairman Desmond; *Reply Comments of Duke Energy North America in CEC Docket 04-IEP-1D, California and Western Electricity Supply Outlook Report*, August 5, 2005.

With the institution of the RAR at the CPUC, older existing resources will retain value for reserves purposes. Stated differently, existing resources that may not have particularly advantageous heat rates retain important market value in terms of satisfying RAR and providing capacity required during peak periods. Whether or not the units are ultimately dispatched would be an issue that reflects either the contracting LSEs' portfolio or the system needs as determined by CAISO.

The ability of these facilities to secure economic support over the longer-run will determine their retirement date. If, for example, a formalized capacity market is developed and the capacity from these resources is not supported in that market, it is reasonable to assume that an asset owner will decide from that market's price signals whether to retire or mothball an asset. Moreover, given the utilities' various competitive solicitations that should be expected during this time period, as long as existing resources (including those already under contract) can bid to provide longer-term resource commitments, then the market mechanism will replace these assets.

DENA believes that the "interim contracting" approach it has advocated for some time will help avoid potential capacity shortages between now and the first expected wave of new infrastructure around 2009. DENA's concern, and its proposed "interim contracting" solution, centers upon the failure of today's wholesale market structure to support existing capacity that does not have a bilateral contract with a load serving entity, and the potential risk to system reliability that could arise should these facilities retire before replacement resources are online. If, as is expected, the CPUC's RAR policy includes the local reliability area capacity requirement by 2007 *and* a formalized capacity market is developed quickly, owners of existing older generation will have market opportunities to invest in newer infrastructure that will provide better fuel efficiency and environmental benefits.

The CEC shares DENA's concern about a potential capacity gap, and believes that the RAR policies and a formalized capacity market, when fully implemented, will provide a strong market-based mechanism to provide new capacity when and where needed. In the meantime, existing capacity should remain available through 3-5 year "interim" contracts to provide time for the implementation of those market mechanisms.

Accordingly, DENA requests that the CEC revise its recommendation to the CPUC and focus on the completion of RAR and implementation of a formalized capacity market, rather than simply long-term contracting by the utilities, but that "interim" contracting of 3-5 years should be taken as a "bridge" to maintain existing capacity during the full implementation of RAR. This suggested revision to the Transmittal Report will better reflect the efforts already underway at the CPUC and elsewhere, and will acknowledge that there are other market-based means of encouraging infrastructure improvement.

Respectfully submitted,

Melanie Gillette

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